

AR21

SKLAR MANUFACTURING LIMITED

1977
annual report

Sklar-Peppler

Meridian
Fitton Parker
CFM

1977 annual report

Sklar Manufacturing Limited

Directors

- *DOUGLAS R. ANNETT
Don Mills, Ontario
President, Annett Partners Limited
- *ALLAN L. BEATTIE, Q.C.
Toronto, Ontario
Managing Partner, Osler, Hoskin & Harcourt
- **PAUL A. BIENVENU
Montreal, Quebec
President, Howard-Bienvenu Inc.,
- **PAUL F. BLACK
Toronto, Ontario
President, Black, Galper & Heessels Limited
- EDWIN T. COHEN
Willowdale, Ontario
Managing Director, ECO Markets Research
and Advisory Associates Ltd.
- JOSEPH SKLAR
Toronto, Ontario
Senior Vice-President
Sklar Manufacturing Limited
- *LOUIS SKLAR
Oshawa, Ontario
President,
Sklar Manufacturing Limited
- SAMUEL SKLAR
Toronto, Ontario
Chairman of the Board
Sklar Manufacturing Limited
- JACK B. WHITELEY
Baie d'Urfe, Quebec
President, Commerce Capital
Corporation Limited

Officers & Executives

SAMUEL SKLAR
Chairman of the Board
LOUIS SKLAR, B.A.Sc.,
President
JOSEPH SKLAR
Senior Vice-President
R. E. G. WILSON, B. Comm., C.A.,
Vice-President, Finance
and Secretary-Treasurer
B. THOMSEN
Vice-President, Marketing
R. A. DONALD, B.A.,
Director of Personnel and
Industrial Relations
J. E. R. DEMERS, R.I.A.,
Assistant Treasurer

Head Office

617 Victoria Street East,
Whitby, Ontario L1N 5S7
Telephone 416/668-3315

Plants

Whitby, Ontario
Weston, Ontario
Hanover, Ontario
Southampton, Ontario

Showrooms

Downsview, Ontario
Weston, Ontario
Montreal, Quebec
High Point, North Carolina

Transfer Agents and Registrars

Common Shares-
Montreal Trust Company
Toronto and Montreal
Warrants-
Guaranty Trust Company
of Canada, Toronto

Bankers

The Royal Bank of Canada
The Mercantile Bank of Canada

Auditors

Soberman, Isenbaum & Colomby

Stock Listing

Toronto Stock Exchange
(SKM) (SKM.WT)

*Member of Executive Committee

**Member of Audit Committee

"Si vous désirez obtenir l'édition française de ce rapport, veuillez écrire à
Sklar Furniture Limited, 617 Victoria Street East, Whitby, Ontario L1N 5S7,
Contacter le Secrétaire-Trésorier."

President's Report to Shareholders

The year 1977 was the most critical one in the history of the company. The losses that were incurred created severe financial problems. However, corrective action was taken and the results have been encouraging. Certainly there are some difficulties lying ahead, but there is now reason for optimism.

For the benefit of those who are not familiar with the events that led to the difficulties of 1977, some brief background information may be helpful. Prior to the current recession, the company enjoyed a number of years of continuing rapid growth in sales and earnings. These years of success led to the development of an ambitious expansion program. The company was well into this expansion when the Canadian furniture manufacturing industry encountered the sharp drop in demand for its products brought about by the downturn in the economy. Because of the large investment involved in the expansion, management made every effort to retain all facilities in full operation in anticipation of an early resumption of growth in demand. Unfortunately, this growth in demand did not materialize. As a result, by the end of 1976, the company found itself saddled with facilities that were substantially larger than it required to meet the reduced demand and with a heavy debt burden created by a combination of the high cost of the expansion program and the losses suffered at its forest products division. Clearly, decisive action became necessary.

Early in 1977, a plan was developed to consolidate the company's operations. One upholstery plant and the dimension plant at the forest products division were completely

closed down, and production at a wood furniture operation was substantially contracted. Action was taken to reduce costs in all phases of the company's operations at all divisions. Early in the year, our shareholders were advised that any recovery that could be anticipated would involve a gradual process and that losses would become more severe before improvements would begin. The anticipated improvements did, in fact, begin in the third quarter of the year and further significant gains were made in the fourth quarter during which the furniture manufacturing divisions again began to generate modest profits. I am now pleased to be able to advise that this pattern of improvement has continued into early 1978.

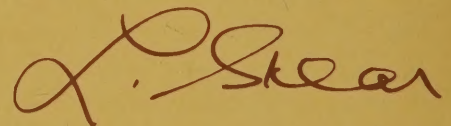
Closing the dimension plant did have the effect of reducing the losses at the forest products division but management concluded that the financial problems of the company called for further action. Accordingly, a decision was taken to dispose of this division. This decision was arrived at with reluctance because it would have the effect of depriving the company of the long term benefits of a primary source of supply of hardwood. On February 28th, 1978, the company entered into an agreement for the sale of its forest products division, subject to certain conditions being fulfilled at a price of approximately \$3.6 million. This transaction will be a significant factor in the company's recovery.

In order to ensure that the company would have adequate funds to carry it through the recovery period, early in the third quarter of 1977, it negotiated an interim arrangement with

its bankers which provided additional finances for its forest products division and, at the same time, made additional cash available to its furniture manufacturing operations. The company has now entered into negotiations with the banks and both the federal and provincial governments for the purpose of arriving at a more permanent arrangement designed to completely reorganize the company's finances in a manner which will result in adequate working capital and substantial relief from its heavy interest costs for a period of several years. The successful conclusion of these negotiations would put the company well on the road to recovery. Although the company's manufacturing facilities have been substantially reduced, it is important to note

that Sklar continues to be the largest manufacturer of upholstered and wood furniture in the country and it has an enviable reputation in the industry. Given relief from the heavy debt servicing costs that it is now carrying, the company should once again become a financially stable and profitable enterprise.

Employees at all levels of the company and at all divisions have demonstrated an admirable dedication to resolving the company's problems. It has required, and continues to require, hard work and sacrifice. The commitment to the company that has been demonstrated by its people, their positive attitudes and their determination to succeed should be appreciated by all shareholders.

A handwritten signature in dark ink, appearing to read "L. Sklar", with a stylized flourish at the end.

Louis Sklar,
President.

March 17, 1978

Consolidated Seven-Year Summary

	1977	1976	1975	1974	1973	1972	1971
OPERATIONS							
Net sales (Note)	\$47,401,000	\$47,082,000	\$41,404,000	\$43,429,000	\$38,116,000	\$28,213,000	\$19,753,000
Earnings (loss) before taxes and extraordinary items	(3,458,000)	(692,000)	(4,025,000)	1,093,000	4,276,000	3,071,000	949,000
Income taxes (recovery)	(103,000)	78,000	(1,244,000)	708,000	1,899,000	1,474,000	487,000
Earnings (loss) before extraordinary items	(3,355,000)	(770,000)	(2,781,000)	385,000	2,377,000	1,597,000	462,000
Extraordinary income (loss)-net	(1,079,000)	796,000	—	—	—	173,000	178,000
Net earnings (loss)	(4,434,000)	26,000	(2,781,000)	385,000	2,377,000	1,770,000	640,000
Depreciation	704,000	798,000	795,000	618,000	505,000	438,000	405,000
CAPITAL EXPENDITURES							
(Before deducting government grants)	198,000	480,000	2,322,000	3,414,000	1,405,000	1,458,000	472,000
FINANCIAL POSITION							
Working capital	3,337,000	8,042,000	4,026,000	7,382,000	6,630,000	4,302,000	3,394,000
Current ratio	1.20:1	1.52:1	1.26:1	1.49:1	1.69:1	1.56:1	1.72:1
Fixed assets (net)	6,474,000	7,131,000	7,935,000	6,806,000	4,436,000	3,923,000	2,964,000
Total assets	26,338,000	30,747,000	27,765,000	29,153,000	20,621,000	15,891,000	11,064,000
Long term debt	7,952,000	8,973,000	5,885,000	4,291,000	1,943,000	1,868,000	3,110,000
Shareholders' equity	1,859,000	6,293,000	6,149,000	8,930,000	8,537,000	5,997,000	3,065,000
PER COMMON SHARE							
Basic net earnings (loss) before extraordinary items	(1.40)	(0.32)	(1.16)	0.16	1.02	0.72	0.25
Basic net earnings (loss)	(1.85)	0.01	(1.16)	0.16	1.02	0.79	0.35
Shareholders' equity	0.77	2.62	2.56	3.72	3.56	2.59	1.67
OTHER STATISTICS							
Approximate number of shareholders	2,100	2,150	1,900	1,900	1,900	1,700	1,800
Common shares outstanding at year end	2,402,969	2,402,969	2,402,969	2,402,969	2,399,810	2,318,754	1,835,741

Note: 1977 and 1976 net sales do not include discontinued operations

Consolidated Balance Sheet

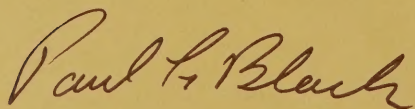
AS AT DECEMBER 31, 1977 (with comparative figures for 1976)

Assets	1977	1976
Current		
Accounts receivable	\$10,781,000	\$10,933,000
Receivable from sale of subsidiary	—	441,000
Inventories (note 2)	8,695,000	11,606,000
Prepaid expenses	388,000	440,000
Total current assets	<u>19,864,000</u>	<u>23,420,000</u>
Due from government agency	—	196,000
Fixed—at cost		
Land	66,000	66,000
Buildings and leasehold improvements	5,162,000	5,288,000
Machinery and equipment	7,050,000	7,093,000
	<u>12,278,000</u>	<u>12,447,000</u>
Less: accumulated depreciation	5,804,000	5,316,000
	<u>6,474,000</u>	<u>7,131,000</u>
	<u>\$26,338,000</u>	<u>\$30,747,000</u>

Approved on behalf of the Board



Director



Director

Liabilities**1977****1976**

(Restated note 13)

Current

Bank indebtedness—current (note 3)	\$10,280,000	\$10,993,000
Accounts payable and accrued charges	4,419,000	3,605,000
Income and other taxes payable	771,000	719,000
Long term debt due within one year	1,057,000	61,000
Total current liabilities	16,527,000	15,378,000

Long term debt (note 4)**7,952,000** 8,973,000**Deferred income taxes**

— 103,000

Shareholders' equity**Capital stock—****Authorized**

3,500,000 common shares without par value

Issued (note 5)

2,402,969 shares

Deficit**Total shareholders' equity**

7,491,000	7,491,000
(5,632,000)	(1,198,000)
1,859,000	6,293,000
\$26,338,000	\$30,747,000

(See accompanying notes to consolidated financial statements)

Auditors' Report

To the Shareholders of

Sklar Manufacturing Limited

We have examined the consolidated balance sheet of Sklar Manufacturing Limited as at December 31, 1977 and the consolidated statements of earnings (loss), deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

The company sustained losses of \$4,434,000 during 1977 and has an accumulated deficit of \$5,632,000. It has substantial debt obligations, with heavy related interest costs, and is in default under certain of its long term debt covenants. In order to assist in attaining a profitable level of operations, the company has entered into an agreement to sell its forest products division, which has incurred heavy losses, and is in the midst of rearranging its debt which will remedy the default and substantially reduce debt servicing costs. (Refer to note 14.)

In our opinion, subject to the ultimate resolution of the matters described in the preceding paragraph, these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

SOBERMAN, ISENBAUM & COLOMBY
Chartered Accountants

Toronto, Canada
March 3, 1978

Consolidated Statement of Earnings (Loss)

FOR THE YEAR ENDED DECEMBER 31, 1977 (with comparative figures for 1976)

	1977	1976
		(Restated note 13)
Net sales	<u>\$47,401,000</u>	<u>\$47,082,000</u>
Operating costs and expenses		
Cost of goods sold	<u>39,496,000</u>	<u>37,352,000</u>
Marketing, general and administrative expenses	<u>7,508,000</u>	<u>6,894,000</u>
Depreciation	<u>446,000</u>	<u>500,000</u>
Interest		
Long term debt	<u>824,000</u>	<u>691,000</u>
Other	<u>952,000</u>	<u>1,131,000</u>
	<u>49,226,000</u>	<u>46,568,000</u>
Earnings (loss) from continuing operations	<u>(1,825,000)</u>	<u>514,000</u>
(Loss) from discontinued operations including depreciation of \$258,000 in 1977 and \$298,000 in 1976 (note 6)	<u>(1,633,000)</u>	<u>(1,206,000)</u>
(Loss) before income taxes and extraordinary items	<u>(3,458,000)</u>	<u>(692,000)</u>
Income taxes (note 7)		
Current	<u>—</u>	<u>98,000</u>
Deferred (reduction)	<u>(103,000)</u>	<u>(20,000)</u>
	<u>(103,000)</u>	<u>78,000</u>
(Loss) before extraordinary items	<u>(3,355,000)</u>	<u>(770,000)</u>
Extraordinary items (note 8)	<u>(1,079,000)</u>	<u>796,000</u>
Net earnings (loss)	<u>\$ (4,434,000)</u>	<u>\$ 26,000</u>
Earnings (loss) per share (note 5)		
Continuing operations	<u>\$ (0.72)</u>	<u>\$ 0.18</u>
Discontinued operations	<u>(0.68)</u>	<u>(0.50)</u>
Loss before extraordinary items	<u>(1.40)</u>	<u>(0.32)</u>
Extraordinary items	<u>(0.45)</u>	<u>0.33</u>
Net earnings (loss)	<u>\$ (1.85)</u>	<u>\$ 0.01</u>

Consolidated Statement of Deficit

FOR THE YEAR ENDED DECEMBER 31, 1977 (with comparative figures for 1976)

Deficit, beginning of year		
As previously reported	<u>\$ (1,316,000)</u>	<u>\$ (1,342,000)</u>
Prior years' adjustments		
Overprovision of income taxes	<u>200,000</u>	<u>200,000</u>
Paid on settlement of litigation with regard to purchase of shares of subsidiary company	<u>(82,000)</u>	<u>(82,000)</u>
As restated	<u>(1,198,000)</u>	<u>(1,224,000)</u>
Net earnings (loss)	<u>(4,434,000)</u>	<u>26,000</u>
Deficit, end of year	<u>\$ (5,632,000)</u>	<u>\$ (1,198,000)</u>

(See accompanying notes to consolidated financial statements.)

Consolidated Statement of Changes in Financial Position

FOR THE YEAR ENDED DECEMBER 31, 1977 (with comparative figures for 1976)

	1977	1976
		(Restated note 13)
SOURCE OF FUNDS		
Proceeds from key man life insurance	\$ —	\$ 900,000
Reduction in current income taxes as a result of loss carry forward	—	93,000
Proceeds from sale of subsidiary company, net of loss on disposition of \$197,000	—	265,000
Conversion of current bank indebtedness to long term	—	2,500,000
Deferral of long term debt payments	<u>36,000</u>	<u>650,000</u>
	<u>36,000</u>	<u>4,408,000</u>
APPLICATION OF FUNDS		
Loss before extraordinary items	3,355,000	770,000
Add credits (deduct charges) not involving funds—		
Depreciation	(704,000)	(798,000)
Deferred income taxes	103,000	20,000
Loss on sale of fixed assets	<u>(15,000)</u>	<u>(24,000)</u>
Funds applied to (provided by) operations	2,739,000	(32,000)
Long term debt due within one year	1,057,000	61,000
Additions to fixed assets—net	198,000	481,000
Provision for loss on disposal of forest products division (less items not affecting working capital)	447,000	—
Loss on closure of upholstery plant (net of loss on fixed assets of \$136,000)	<u>300,000</u>	<u>—</u>
	<u>4,741,000</u>	<u>510,000</u>
Increase (decrease) in working capital	(4,705,000)	3,898,000
Working capital, beginning of year	<u>8,042,000</u>	<u>4,144,000</u>
Working capital, end of year	<u>\$3,337,000</u>	<u>\$8,042,000</u>

(See accompanying notes to consolidated financial statements.)

Notes to Consolidated Financial Statements

DECEMBER 31, 1977

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Principles of consolidation

The consolidated financial statements include the accounts of the company and its subsidiaries, all of which are wholly owned.

b) Translation of foreign currencies

Current assets and liabilities of a foreign subsidiary have been translated into Canadian dollars at the year end rates of exchange. Fixed assets are translated at historic rates and income and expenses at average rates of exchange in existence during the year. The exchange adjustment arising from such translation has been reflected in earnings.

c) Inventories

Inventories are valued at the lower of cost and net realizable value, with cost determined on a first in, first out basis.

d) Depreciation

Depreciation is provided in the accounts on the straight line method over the estimated useful lives of the fixed assets as follows:

Buildings	— 20-40 years
Leasehold improvements	— over the unexpired terms of the leases
Machinery and equipment	— 10 years

e) Pensions

Substantially all of the company's employees are covered by company pension plans as well as by compulsory government plans. The unfunded past service obligation is being amortized annually to 1989.

f) Discontinued operations

These operations have been accounted for separately from continuing operations (note 6).

2. INVENTORIES

At December 31, inventories consist of:

	1977	1976
Raw materials	\$3,973,000	\$ 5,599,000
Work in process	1,949,000	2,037,000
Finished goods	2,773,000	3,970,000
	<u>\$8,695,000</u>	<u>\$11,606,000</u>

3. BANK INDEBTEDNESS – CURRENT

Current bank indebtedness of \$10,280,000 and the \$2,000,000 bank term loan due in 1983 are secured by substantially all the accounts receivable and inventories as well as debentures in the total amount of \$10,000,000 of two subsidiary companies. These debentures are secured by fixed charges on the fixed assets of the two subsidiaries and floating charges on all other assets subject to the fixed and floating charges relating to other long term debt (note 4).

4. LONG TERM DEBT

	1977	1976
Bank term loans due to 1983		
2% above the lender's prime rate	\$3,400,000	\$3,400,000
2¾% above the lender's prime rate	2,500,000	2,500,000
2¾% above the lender's prime rate (minimum 11½%)	2,000,000	2,000,000
Loans from Ontario Development Corporation		
9% due 1979	109,000	134,000
8% due 1985	1,000,000	1,000,000
	<u>9,009,000</u>	<u>9,034,000</u>
Less amounts due within one year, included in current liabilities	1,057,000	61,000
	<u>\$7,952,000</u>	<u>\$8,973,000</u>

a) Security

Subject to the assets pledged against bank indebtedness as referred to in note 3 the remaining long term debt is secured by fixed charges on buildings, equipment and leasehold improvements and floating charges on all other assets.

b) Restrictions

The requirements with respect to maintaining working capital and shareholders' equity levels vary by lender and the most extreme restrictions require the company to maintain working capital and shareholders' equity of \$5,000,000 each. At December 31, 1977 the company had working capital of \$3,337,000 and shareholders' equity of \$1,859,000 and is therefore in default. The lenders have indicated that no immediate action is to be taken as a result of these defaults because of the pending sale of the forest products division and the financial rearrangement under discussion (note 14).

There are also limitations on the purchase of fixed assets, lease commitments and dividend payments.

c) Payments

Payments required on long term debt in the next five years are as follows:

1978 – \$1,057,000	1981 – 1,125,000
1979 – 1,157,000	1982 – 1,136,000
1980 – 1,115,000	

5. CAPITAL STOCK

As at December 31, 1977, 298,409 common shares were reserved for possible issue upon exercise of share purchase warrants at a price of \$3.50 per share, exercisable until July 1, 1978. The exercise of the outstanding warrants would not have had a dilutive effect on earnings (loss) per share in 1977 or 1976.

6. DISCONTINUED OPERATIONS

During 1977 the decision was made to sell the forest products division. On February 28, 1978 the company entered into an agreement of sale which is to close on April 28, 1978 (note 14 a). The operations of this division for the years 1977 and 1976 have been excluded from net sales, operating costs and expenses in the statement of earnings and shown instead as a single item "loss from discontinued operations".

	<u>1977</u>	<u>1976</u>
Loss from discontinued operations before interest expense		
Forest products division	\$1,633,000	\$ 858,000
Subsidiary sold in 1977, as originally reported	—	348,000
	<u>\$1,633,000</u>	<u>\$1,206,000</u>

The loss on the disposal of the discontinued operations and other costs relating thereto have been reported separately as an extraordinary item (note 8).

7. INCOME TAXES

At December 31, 1977, the companies have loss carry forwards for income tax purposes of approximately \$6,275,000 for deduction against future years' profits. These loss carry forwards expire as follows:

1980	—	\$2,525,000
1981	—	300,000
1982	—	3,450,000
		<u>\$6,275,000</u>

8. EXTRAORDINARY ITEMS

	<u>1977</u>	<u>1976</u>
Provision for loss on disposition of forest products division including estimated 1978 operating losses to date of sale and loss on sale of fixed assets	\$ (643,000)	\$ —
Loss on closure of upholstery plant consisting of loss on disposal of fixed assets and provision for leasehold termination costs	(436,000)	—
Proceeds from key man life insurance	—	900,000
Loss on disposition of subsidiary	—	(197,000)
Reduction in current income taxes as a result of loss carry forward	—	93,000
	<u>\$(1,079,000)</u>	<u>\$796,000</u>

9. REMUNERATION OF DIRECTORS AND SENIOR OFFICERS

The total remuneration paid or payable by the company and its subsidiaries to its directors and senior officers amounted to \$390,000 in 1977 and \$386,000 in 1976.

10. PENSION PLANS

Pension costs, including amounts for compulsory government pension plans, were \$418,000 in 1977 and \$483,500 in 1976. These amounts include current service costs and payments on account of the unfunded liability in respect of past service.

At January 1, 1977, the date of the last actuarial review, the unfunded obligation for past service was approximately \$350,000.

11. LONG TERM LEASES

The company is committed under long term leases with various expiry dates to 1995. Minimum rentals (exclusive of taxes, insurance and maintenance costs) for the next five years under these leases are approximately \$750,000 annually.

12. ANTI-INFLATION ACT

Under the federal government's Anti-inflation Program (presently scheduled to be in force until December 31, 1978) the company is subject to mandatory compliance with legislation which controls prices, profit margins, employee compensation and shareholder dividends. Management is of the opinion that the company is in compliance with the requirements of the Anti-inflation Act.

13. COMPARATIVE FIGURES

The comparative figures for 1976 have been restated to give effect to the prior years' adjustments reflected on the statement of deficit and to provide comparative information for discontinued operations (note 6).

14. SUBSEQUENT EVENTS

a) Sale of forest products division

On February 28, 1978 the company entered into an agreement to sell the assets pertaining to this facility consisting of land, buildings, machinery and equipment for \$3,000,000 plus net current assets at book value. The sale price is to be satisfied by the purchaser assuming the Ontario Development Corporation \$1,000,000 8% loan and the company receiving a 9% debenture for \$1,400,000 (due \$300,000 90 days after closing and the balance from 1981 to 1985) and cash for the remainder.

The agreement is to be completed on April 28, 1978 and is conditional upon certain government agencies participating in financing the acquisition for the purchaser and obtaining the consent of the long term lenders to whom the assets have been pledged.

The loss on sale has been accounted for as at December 31, 1977 (note 8).

b) Financial rearrangement

Discussions are being held with the company's bankers with respect to a financial rearrangement designed to assist the company in its future operations whereby current bank indebtedness and long term debt would be reorganized. This would result in substantially reduced debt servicing costs and remedy the defaults under its long term debt covenants. The conditions and restrictive covenants which are to be agreed upon before finalizing a formal agreement have not been fully determined.

